

Sales Tax Evasion – Multistate Issues
John P. Gray, LL.M. (tax), J.D., M.B.A., M.A.R.

High profile tax evasion cases historically involve primarily income tax matters. However, sales tax evasion cases are of growing government interest as state budgets tighten. In a quest for revenue, state governments are looking for revenue wherever it may be found. In Tennessee, a state that does not have state personal income tax on wages (although it does impose personal income tax on certain dividends and interest income¹), a Memphis business owner was indicted on twenty two counts of Sales Tax Fraud in violation of Tenn. Code Ann. Section 67-1-1440, a Class E felony.² In January, 2013, two brothers pleaded guilty in a scheme to defraud the state of Illinois of more than \$5 million in unpaid sales taxes.³ States with a sales tax generally also have a use tax. Use tax is not due in addition to sales tax, but is due when non-sales taxed items are brought into a state and used there. Generally, when an item is purchased in a state where sales tax is not imposed, and is brought into a state for use where there are sales and use taxes, use tax is due on that item in the amount of the sales tax in the state where the item is used. Many states have a form to utilize for paying use tax, but a great deal of use tax due probably goes unpaid each year. Evading any tax is illegal, but some types of evasion are more difficult for states to monitor than are others. No U.S. jurisdiction imposes a death penalty for tax evasion, but China had tax fraud listed as a death penalty offense until 2011.

Sales Tax is of State and/or Local Character

There is not a general federal sales tax in the United States. So, enforcement as to sales tax violations are generally handled at the state or local level. U.S. sales taxes are state and/or local in character. Of the 50 states, 45 states have a sales tax. The states of New Hampshire, Delaware, Montana, Oregon and Alaska do not have a general sales tax.⁴ Alaska does allow cities to impose a general sales tax, but most cities choose not to do so and there is no state wide general sales tax in Alaska.⁵ Some states charge the same rate of sales tax statewide, but many charge a sales tax at the state level and then allow local governments to add to the state imposed sales tax. Since many states

have different sales tax rates from city to city, the diversity as to imposition of the sales tax has resulted in more than 12,000 different sales taxing jurisdictions in the United States. The highest general sales tax rate currently charged in the United States is in Montgomery and Mobile, Alabama at 10%. 10% sales tax is not a historical high nationally. For a few years, an area close to Chicago, Illinois had a sales tax of 10.25%.⁶ The sheer number of sales tax jurisdictions, even often in different areas within the same state, with various rates and exemptions as to taxable items, makes sales tax particularly difficult and costly to monitor.

Sales Tax Evasion is Often Difficult to Detect

All states have a property tax, 41 have a state income tax, and as noted above, 45 states have a general sales tax. Which of these taxes is easiest to monitor and to police? In January, 2013, Nebraska Governor, Dave Heineman proposed abolishing the personal and corporate income taxes in Nebraska and shifting to more state government dependence on the sales tax.⁷ If this plan goes forward, it will be interesting to see what it will cost a state to monitor a system that is more dependent on sales tax. Since the federal income tax applies in every state, there is much more of a paper trail to assist in detecting state income tax evasion. With real property taxes, the land is either owned by someone or it is not. Land cannot be hidden as easily as can business and personal transactional details for goods and services. New Hampshire, a state without a general sales tax and without a personal state income tax, depends heavily on real property taxes⁸, but no state operates without a property tax. It is less difficult for a state to monitor who owns real estate, or who earns taxable income, than it is for a state to monitor tens of thousands of sales transactions every week. Searching for sales tax violations may be very time consuming in relation to the recoveries or benefits derived from their pursuit.

Ex Post Facto Laws, The Sales Tax and Mail Order Sales

Mail order sales make the sales tax environment complex. Millions of dollars in sales each month are generated from catalog sales. Often, the orders are placed from those in one state to a catalog retailer in another state. Should an out of state retailer collect sales tax on purchases going to states where the seller does not have a physical presence, a store, warehouse, or offices? This question is further complicated by the fact that not all states have historically followed the same view as to the location of mail order sales. When a person orders something from a catalog, is the place of sale where the catalog retailer is based or where the customer has the goods delivered? Also, the Due Process Clause and the Commerce Clause of the United States Constitution are implicated in this discussion. Due process relates to what is fair and reasonable. There was a time when physical contacts, called nexus, were required for an out of state business to be required to collect sales tax based on sales within another state.⁹ However, the law has evolved in this area to demonstrate that if a business makes efforts to reach customers in another state, it is reasonable and fair to require more of that business than was required in the past. A discussion of the Due Process Clause and the Commerce Clause, as they apply to sales taxes, will follow in a later article. Before closing this article, a mention of ex post facto laws is needed to highlight an important legal difference.

Many people are well aware that the U.S. Constitution forbids Congress from passing ex post facto laws.¹⁰ However, the prohibition as to ex post facto laws applies to criminal laws, not to all areas of law. Congress passes retroactive tax laws on a regular basis. When Hurricane Katrina hit the United States, Congress passed many measures that were retroactive to January of the year when the hurricane reached U.S. shores. As to the alternative minimum tax, Congress has, in recent years, waited until December to pass measures that were retroactive to the prior January. Since retroactive tax laws, can

be, and often are, passed. Consider the tax burden to a retailer who does not collect sales taxes on out of state purchases should Congress decide at the end of a year to require that these taxes be paid to all states where the buyers are subject to sales tax. It would be practically impossible to collect those sales taxes from thousands of purchasers, weeks, or even months, after the original sales. So, the business could have a substantial burden placed on it to pay these various amounts due. It appears that to collect the taxes as sales are made, and to pay them, is a safe course for a business. Although there are thousands of sales tax jurisdictions in the U.S., with today's technology, computers can keep up with the sales tax that charged in each of these jurisdictions. Prior to the computer age, it would have been an undue burden on interstate commerce to require that efforts like these be made. Today, technology has reduced the burdens placed on commerce in many ways, but it also has increased business duties.

Endnotes

- 1 Internal Revenue Service Reports, September 1, 2010, last accessed: February 13, 2013 <http://www.irs.com/articles/tennessee-state-taxes>
- 2 Tennessee Government News and Media Center, August 17, 2011, last accessed: February 13, 2013 <http://news.tn.gov/node/7624>
- 3 Associated Press Archive, January 26, 2013, last accessed: February 13, 2013 [http://www.apnewsarchive.com/2013/2-Chicago-area-brothers-plead-guilty-to-\\$5-million-in-Illinois-sales-tax-fraud/id-60713b873adb4e59a5888bef48b3c274](http://www.apnewsarchive.com/2013/2-Chicago-area-brothers-plead-guilty-to-$5-million-in-Illinois-sales-tax-fraud/id-60713b873adb4e59a5888bef48b3c274)
- 4 Moreno, Tonya, States Without a Sales Tax, no date, last accessed: February 13, 2013 <http://taxes.about.com/od/statetaxes/a/States-Without-A-Sales-Tax.htm>
- 5 Id.
- 6 Lilly, Aster C., Chicago Has The Highest Sales Tax in the United States: 10.25%, July 24, 2008, last accessed: February 13, 2013 <http://voices.yahoo.com/chicago-has-highest-sales-tax-united-states-1704907.html>
- 7 Knapp, Fred, Net, Nebraska's PBS and NPR Stations, Heineman Proposes to End Nebraska Income Taxes, January 15, 2013, last accessed: February 13, 2013 <http://www.netnebraska.org/article/news/heineman-proposes-end-nebraska-income-taxes>
- 8 New Hampshire Government, last accessed: February 13, 2013 <http://www.nh.gov/residents/taxes.html>
- 9 National Bellas Hess v. Department of Revenue, 386 U.S. 753, 87 S.Ct. 1389 (1967).
- 10 United States Constitution, Article One, Section 9.